City of Detroit

CITY COUNCIL

DAVID D. WHITAKER
Director
(313) 224-4946

DIVISION OF RESEARCH & ANALYSIS
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 216
Detroit, Michigan 48226
(313) 224-4946
FAX: (313) 224-0368

PEGGY ROBINSON
Deputy Director
(313) 224-4946

TO: The Honorable City Council

FROM: David Whitaker
Julianne Pastula

DATE: May 10, 2006

RE: VENEZUELAN OIL INITIATIVE

At the Honorable City Council's request, the Research & Analysis Division (RAD) submits the following report regarding energy assistance programs offered by the Venezuelan government through CITGO Petroleum Corporation.

A. CITGO Energy Assistance Program in Detroit

This Honorable Body has exchanged correspondence with the Venezuelan Consulate expressing interest in an energy assistance program that would benefit low-income residents of Detroit and are anticipating a proposal from Venezuelan representatives. The proposal could reflect CITGO's desire to provide low cost heating fuel to lower income residents through non-profit organizations or an intention to relieve some of the fiscal pressures the City of Detroit government is facing in its budget by offering to provide low-cost diesel fuel for DDOT, public lighting or other City departments. The majority of energy assistance provided to U.S. residents by CITGO has been in the form of heating oil. The majority of homes in Detroit utilize natural gas for home heating purposes. An analysis of the number of residents that would be impacted from the procurement of either fuel should be conducted prior to the finalization of any agreements relative to the type of fuel that can be obtained at the most significant discount that will have the greatest impact on our community.

After receiving the proposal, other practical considerations can be resolved such as the type of oil that is being offered (refined, unrefined, natural gas, diesel) and the method for procuring and storing the oil until its use. Until the type or grade and quantity of fuel being offered is known, it is impossible to generate an analysis of the benefits. RAD is prepared to supplement this report based on information received from the representatives from the Venezuelan government. For example, if discounted diesel fuel for DDOT buses is available (similar to the offer from Chicago), a cost-benefit analysis is necessary to determine the savings to the City and ascertain the budgetary impact. Protocols for DDOT to implement the reduced fares to eligible residents will also need to be devised. RAD has requested current contracts between the City of Detroit and providers of diesel fuel and other forms of energy from the Purchasing Department for review and comparison. Analysis of the City's procurement procedures relative to the purchase of fuel may also be required, depending on the offer from CITGO. RAD has also requested statistics from The Heat and Warmth Fund (THAW), a local non-profit organization that provides home heating assistance. In 2005, THAW helped an estimated 12, 000 families last year and distributes $4.5 million dollars in heating assistance annually through more than 100 agencies across Michigan.

B. 2005-2006 Energy Assistance Programs in the United States

Venezuelan President Hugo Chávez first announced a plan to provide discounted oil to poor U.S. communities in September of 2005 during a speech before the United Nations. The "oil-for-the-poor" program (energy assistance programs) was proposed after financial assistance (both monetary and oil) was provided as part of hurricane relief efforts. The majority of the energy assistance programs were accepted by Northern Atlantic States, which represent 80% of the heating oil consumption in the United States.

Massachusetts was the first state to sign an agreement with CITGO. In November of 2005, Citizens Energy Corporation, with the assistance and involvement of U.S. Representative William Delahunt, arranged to purchase and distribute 12 million gallons of hearing oil to low-income and elderly residents. The oil was used by 45,000 families and was sold at a 60 to 80 cent reduction in price for a total savings of approximately $10 million dollars. Citizens Energy Corporation and Mass Energy, two non-profit organizations, distributed the oil to eligible households.

The second U.S. community to accept the energy assistance program was the Bronx, NY on December 6, 2005. CITGO entered into a deal with three non-profit housing organizations to deliver 5 million gallons of heating oil for 40% below market rate. This amounts to a $4 million dollar savings that will be reinvested in the community through social programs operated by the non-profits, rent reduction vouchers and quality of life improvements to apartment buildings.

The third state to benefit from subsidized Venezuelan oil was Rhode Island. Sen. Jack Reed[1] of Rhode Island received an offer from CITGO relative to an energy assistance program after a group of senators that he was a part of sent correspondence to ten major oil companies requesting that 10% of the record third quarter profits of $33 billion dollars be donated to heating assistance programs[2]. CITGO was the only company to respond. Rhode Island received 3.3 million gallons of discounted heating oil to benefit low-income families, homeless shelters and community clinics. The oil was shipped to Citizens Energy Corp., which sold it to its customers and reimbursed the local oil companies that actually delivered the fuel at a 40% discount to low-income consumers.

In Pennsylvania, U.S. Representative Chaka Fattah negotiated the agreement with CITGO for 5 million gallons of heating oil at a 40% discounted rate helped 25,000 low-income families in Philadelphia with their winter heating costs. The Governor hopes to expand the program to the rest of Pennsylvania.

Maine entered into a January 12, 2006, agreement with CITGO for 8 million gallons of heating oil at a 40% discount, representing a $5.5 million dollar savings. The oil benefited

[1] The legislation that Sen. Reed proposed which would have established a windfall profit tax on excess oil profits failed in the Senate. The proposal would have altered the calculation of taxes for oil held in inventory, resulting the 5 largest U.S. oil companies to pay an additional $4.3 million dollars in taxes.

[2] In 2005, Exxon Mobil reported $36 billion dollars in earnings that represents the larges profit recorded by a company. Based on its 2005 earnings, the company averaged $98 million dollars in profits per day.

recipients of the Low Income Home Energy Assistance Program (LIHEAP)[3] whose benefits had expired, the Passamaquoddy, Penobscot, Micmac, and Maliseet Native American Nations as well as homeless shelters. Maine's 48,000 LIHEAP recipients each received $100 worth of heating oil. The Native American Nations bought 900,000 gallons of oil at a savings of $543,00.00 and CITGO donated 120,000 gallons of heating oil to 40 homeless shelters in Maine.

The State of Vermont has also benefited from the oil for the poor programs. The seventh supply of subsidized heating oil aided the residents of Delaware. The agreement, for 1.1 millions gallons of heating oil at a 40% discount, benefited 20,000 low-income households. Of that amount, 150 gallons of heating oil was donated to heat 20 homeless shelters. The subsidized oil provided to the State of Delaware is estimated to have a market value of $40 million dollars. The Delaware Department of Health and Social Services, working through catholic charities, oversaw distribution of the heating oil by the Citizens Energy Corporation.

Connecticut received 4.8 million gallons of heating oil at a 40% discount for low-income households in March of 2006. The recipients must qualify for state assistance in order to receive the subsidized oil.

In total, over 25 million gallons of home heating oil was sold to 100,000 low-income households in the Northeast at discounted prices. The discounted oil program ended on April 1, 2006, with the onset of warmer weather.

Instead of oil for heating purposes, the Chicago Transit Authority (CTA) received a proposal from CITGO for low-cost diesel fuel (at a 40-50% discounted rate) to alleviate transportation costs for low-income residents in Illinois. CITGO stipulated that if the its unilateral offer was accepted, the CTA would be required to pass the savings on to low-income residents in the form of free or discounted fares. Although facing a budget deficit that necessitated an increase in fares, the CTA rejected the offer in January. Under pressure from state and local politicians and community groups, the CTA agreed to resume talks with CITGO. The major difference between the East Coast beneficiaries of the oil for the poor program and the offer to the CTA is that the CTA is a government agency and the prior agreements had been with non-profit organizations. The CTA relies on the federal government for the majority of its funding and recently received $89 million dollars for infrastructure projects from a Federal Transportation Appropriations bill.

C. 2006-2007 Energy Assistance Programs in the United States

President Chávez has already announced plans to continue the oil-for-the-poor program in the United States during the upcoming winter. He indicated the program would be expanded from 40 million gallons that was provided this year to 80 million gallons in the 2006-2007 winter season. In addition to the 40% discount that is provided, President Chávez proposed that 30% of the funds from the sale of subsidized oil be set aside for special local development funds in the communities receiving the energy assistance and the remaining 30% of the funds would go to CITGO.

[3] The federal Low Income Heating Energy Assistance Program was cut in 2005 to the lowest level since 1998, even as fuel costs were predicted to increase up to 50% during the winter months.

President Chávez also expressed an interested in extending some of the health care initiatives such as "Mission Miracle" outside of Venezuela's borders. One example is the provision of free eye surgeries for cataracts, myopia, as well as other conditions throughout North and South America. President Chávez' initial proposal includes quotas for each country (i.e. United States 150,000; Brazil 100,000; 60,000 Columbians; and 20,000 Bolivians). By December 2006, it is anticipated that over 150,000 Venezuelans will have received free eye operations.

The continuation of the energy assistance program could be in jeopardy. The relationship between the socialist Venezuelan and the U.S. governments have been strained. The Bush Administration does not support President Chávez because of his opposition to the Free Trade Area of the Americas (FTAA) proposal, his criticism of the Administration's response to poverty in the U.S., opposition to U.S. foreign policy and his involvement in anti-Bush rallies[4].

In addition to the tenuous political situation that could threaten the energy assistance program, in February of 2006, the Chairman of the House Energy and Commerce Committee[5] began an investigation into the Venezuelan oil-for-the-poor program, requesting all records related to the program to determine if the donations are "part of an unfriendly government's increasingly belligerent and hostile foreign policy" or are in violation of stateside anti-trust laws. Even though CITGO was the only major oil company that answered the federal government's request to help poor communities using a portion of the oil profits it receives.

D. Background Information

The Petróleos de Venezuela, S.A. (PDVSA) is Venezuela's national petroleum corporation. It is the only member of the Organization of Petroleum Exporting Countries (OPEC) from South America and holds the largest energy reserves of any country outside of the Middle East. The PDVSA entered the United States oil market in 1986 by purchasing oil firms, refineries and retail outlets. Its purchase of CITGO in 1989 made Venezuela the first OPEC member to wholly own a major U.S. refinery. Currently, Houston-based CITGO licenses 14,000 gas franchises and operates 8 refineries in the United States. In the 20 years that the Venezuelan government has owned & operated CITGO, the company has never paid itself dividends. Only in 2004 and 2005 did it begin to repatriate a portion of its profits to Venezuela. It exports approximately 60% of its oil or approximately 1.5 million barrels per day to the U.S.[6], which represents 15% of U.S. oil imports[7].

Prior to the move toward nationalization of the state's resources, the PDVSA's oil policy was known as internationalization. It privatized the Venezuelan oil industry, which resulted in financial losses to the nation's economy since the oil revenues were not being reinvested in the country and successfully evaded taxation. One of the accomplishments of the national strike in December 2002 through January 2003 was that the Ministry of Energy and Petroleum was reformed and the PDVSA was reorganized to focus on public accountability and the pursuit of

[4] The Administration has also threatened to restrict the Venezuelan ambassador's movement within the U.S. There are also allegations that in 2002, the Bush Administration endorsed a failed coup attempt against Chávez, a democratically elected President of a sovereign nation.
[5] The Chairman is Texas Republican Joe Barton.
[6] Venezuela is the 4th largest supplier of oil to the U.S. behind Canada, Mexico and Saudi Arabia.
[7] The U.S. represents 5% of the world's population and consumes over 25% of oil and energy resources.

national oil sovereignty. In April 2006, President Chávez seized two oil fields[8] because the foreign corporations were unwilling to give more control of their operations to the PDVSA[9].

As part of the country's political restructuring, the PDVSA promotes a new economic model, Fondespa (The Fund for Social and Economic Development) that strives to end social inequalities and eradicate rural and urban poverty by distributing oil revenues for the betterment of the population at-large. Three trusts for public investment were created to accelerate national development projects. One of the trusts is funded with approximately $2 billion dollars to build hydro and electric power plants, a sugar refinery, sponsor the new national airline and invest in irrigation systems for rural farmers. Other social programs to improve quality of life include health and education initiatives, childcare, food assistance and job training. The goal of President Chávez is to use Venezuela's energy wealth to improve quality of life for its citizens. All of the initiatives are funded using oil revenues that are far above the anticipated profits of $40 per barrel. Today, light crude oil for June delivery was $70.50 per barrel according to the New York Mercantile Exchange.

E. International Energy Initiatives

Venezuela exports 100,000 barrels of oil per day to Cuba in exchange for medical personnel to assist low-income Venezuelans. It also is a member of Petrocaribe[10], an energy organization of 14 Caribbean countries with the goal of solving problems with access to energy for consumers who have no state control over their energy resources. Under the agreement, Caribbean governments would purchase Venezuelan oil at market prices. Whenever prices surpass $40 per barrel, Venezuela will finance 40% of the cost to be payable over a period of 17-25 years. There is a two-year grace period for long-term payments (up to 25 years) and the interest rate is limited to 1%. Further concessions are available if the price of oil exceeds $100 per barrel. The grace period for short-term payments was extended from 30 to 90 days. It also provides that portions of the oil tab can be paid with services or goods such as rice, bananas or sugar. The country is also exploring energy partnerships with other South American countries including a proposal to construct a natural gas pipeline[11] extending from Venezuela to the tip of Patagonia.

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[8] The Total group, of France, and Ente Nazionale Idrocaburi, of Italy, operated the two fields.

[9] In a more drastic move towards nationalization, on May 1st, President Morales of Bolivia placed the country's oil and gas reserves under state control, giving the foreign companies 180 days to renegotiate their contracts or leave the country. The Bolivian reclamation is intended to nationalize Bolivia's energy industry.

[10] Antigua and Barbuda, Bahamas, Belize, Dominican, Cuba, Grenada, Guyana, Jamaica, Dominican Republic, St. Kitts and Nevis, Santa Lucia, Saint Vincent and the Grenadines, Surinam and Venezuela signed the Energy Cooperation Agreement on June 29, 2005.

[11] Venezuela has the second greatest proven reserves of natural gas in the Western Hemisphere. A PDVSA subsidiary, Petroquímicas de Venezuela - Pequiven (Pequiven), is responsible for petrochemical development and production.